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MOSCOW FOR TOM HUFFAKER

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SUBJECT: KING COAL'S COMEBACK

REF: CALGARY 0622

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SUMMARY  
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1. In a surprise to many energy economists, King Coal is returning to the throne. As recently as two years ago, many experts were predicting a rapid demise for a fuel long associated with black lungs and melting ice caps, but the outlook is once again promising for an industry older than the Industrial Revolution itself. Coal is the world's largest and one of its fastest growing energy sources, with its 38% share of global electricity generation likely to grow over the next two decades. While developed nations have largely shunned increasing coal use in favor of cleaner energy sources, the developing world has more than made up for the West's stagnant demand. Fueled in part by rising consumption in China and India, this unexpected increase has been the driving factor in the booming coal contract market, where several pricing records were broken earlier this year.

2. As one of the world's larger coal-exporting regions, and a center of research for new coal technologies, Alberta stands to gain much from the new market realities. Alberta's nine thermal coal mines produce up to 30 million tons a year (followed closely by British Columbia producing primarily metallurgical coal) representing nearly half of Canada's yearly output of 67 million tons (the industry employs about 4500 persons). Additionally, the province's coal industry has plenty of room to expand, with Alberta's 33.6 gigaton coal reserve comprising 60% of Canada's reserve, the tenth largest in the world. While unresolved environmental and economic issues may hamper the development of the province's coal industry, the opportunity for wealthy companies newly flush with resource dollars is substantial. End Summary.

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THE OTHER BLACK GOLD  
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3. With 60% of Canada's total coal reserves and enough in-province to last for nearly a thousand years at current extraction rates, Alberta has the potential to capture a large portion of the world export market. Thermal coal from Alberta mines contains less sulfur and burns cleaner than that of other provinces, making it an attractive fuel source in a Kyoto-constrained nation. Alberta currently produces about 30 million tons of thermal coal each year, or 43% of Canada's total. The majority of production (about 80%) eventually makes its way to coal-fired power generators within the province, with the remainder shipped overseas, primarily to Japan and South Korea. Alberta is also one of the few provinces currently expanding coal power facilities, with 32% of all new electricity capacity from 1999-2007 coming from a fuel that is, almost literally, still cheap as dirt.

4. Although the recent international recognition of Alberta's oil reserves has overshadowed a growing manufacturing capacity, an expanding telecommunications sector, and virtually everything else of interest in the booming province, increased demand for coal ensures the commodity's future as an integral part of the local economy. Provincial royalties from Alberta's nine mines amount to around C\$10 million per year. While this figure pales in comparison to the C\$14 billion the provincial government was paid in 2004 by the oil and gas companies, Alberta is hoping that high coal prices will result in more mines "paying out," allowing the province to benefit from taxes on profit. One oft-quoted statistic estimates that Alberta's coal reserve has twice the energy potential as all other non-renewable energy resources in the province, including crude oil, bitumen, and natural gas. At current rates of consumption, this oft-overlooked energy bonanza will last another 800 years.

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A LUMP OF COAL IN ALBERTA'S STOCKING  
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5. According to Jim Popowich, President of Alberta-based coal giant Fording Canadian Coal Trust, "Unprecedented demand from

China has driven the price of coking (metallurgical) coal to historic highs. Annual increases from China in their steel productions have dwarfed anything that we've seen in the past couple of decades". The Energy Information Administration (EIA) predicts world consumption of coal will increase by at least 40% by 2025. While metallurgical coal will fuel much of this increase, Alberta exporters are placing their bets on the thermal coal used for electricity generation. Many of the nations where demand for thermal coal is most rapidly increasing are in the developing world, where Kyoto restrictions do not apply and strong environmental lobbies have yet to form. (Note: Thermal coal is lower quality coal used to process heat, steam and electricity generation. Metallurgical coal is higher quality used primarily for making steel in integrated steel mills using the basic oxygen furnace.)

16. This isn't the first time rising interest in coal has created a mini-boom in the industry: Popwicz adds that: "History has shown how sometimes we can be our own worst enemies, and that we go out and do a significant supply increase only to have the market fall on us." The Alberta coal industry has been more cautious during the recent upsurge in coal prices, with most of the increase in production coming from upgrades and the reopening of old mines. Long term prospects for growth are more promising; dozens of small companies have entered the market, several of them with plans for new mine expansions. Allen Wright, Executive Director of the Calgary-based Canadian Coal Association of Canada (CAC) told us that in Canada, "Five years ago, half the companies in existence today hadn't started producing. Business is booming". Wright previously told CG that, "there is more stored energy in Canadian coal than the country's oil, natural gas and oilsands combined", pointing out that coal makes up "more than 92% of North America's hydrocarbon reserves". Insisting that coal gets a "bum rap", Wright outlined a future driven by new clean coal technologies, seeking ways to improve coal-burning technologies and reduce emissions. He also pointed out that Western Canadian coal is considered "cleaner" because of its low sulphur content.

17. The value of coal is notoriously difficult to predict; in the absence of global standards like those for oil, natural gas, or gold, the price of coal is determined on a contract basis, with most companies and power facilities preferring to strengthen ties with existing suppliers than to develop new relationships. The average negotiated price in 2004 was US\$64 per ton. Following a record US\$125 per ton of coking coal secured by Alberta Grande Cache Coal Corporation in a contract earlier this year, the price has stabilized between US\$110 per ton and US\$120 per ton. These prices recently prompted Australian think tank Access Economics to declare metallurgical coal the "most overvalued" mineral of 2005. Prices negotiated for thermal coal have been close behind, though generally lower because of the commodity's lower purity. A decrease in price is expected next year, but a return to the market of 2004 is unlikely.

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TRUST US, WE'RE NOT A MONOPOLY  
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18. The upswing in the coal market couldn't have come at a better time for Alberta. A comprehensive restructuring of the coal industry occurred in 2003, when five Canadian companies and mutual funds came together to create Calgary-based Fording Canadian Coal Trust, the second largest metallurgical coal producer in the world. Under Jim Gardner, first president of the Trust, Fording instituted many efficiency and belt-tightening measures, including the downsizing of hundreds of workers in British Columbia. The strategy would pay off in 2004, when Fording first turned a profit. The trust is still in the process of transformation and expansion, with employee rolls up 50% in preparation for mine upgrades next year. The majority of operations for Fording are in SE British Columbia, with five metallurgical mines in Elk Valley, and one nearby in Alberta.

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WITH GREAT PROFITS COME GREAT CHALLENGES  
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19. However, the future of Fording and other coal producers based in Alberta is uncertain. While the industry is currently sitting on large cash reserves resulting from the high prices, rising transportation costs threaten to eat away at profit margins. Shipping costs for Fording were up by a third in 2004, with soaring fuel prices promising further damage to the company's bottom line. Another factor in rising expenses has been Canadian National Railway's tenuous relationship with labor; tensions between the railroad giant and unions erupted into a month-long strike in March of last year, causing expensive delays in coal shipments. Icy relations with the provincial and federal governments have also hampered further development for Fording, which will soon be forced to pay a higher royalty rate as its profits expand beyond the limits of its original tax shelter. Even more damaging to the Trust is legislation passed last year which causes organizations like Fording to lose their mutual

fund status if they are more than 49% foreign-owned. Currently, Fording is 56% Canadian-owned, but with Asian investors eager to pour money into their mines, the trust is actively screening new shareholders to ensure compliance.

10. Apart from Fording, numerous smaller coal mining companies have expanded operations in Alberta over the past five years. The largest, Luscar Energy Partnership, purchased Fording's thermal coal assets in 2003 and continues to be the most important domestic source of coal for Alberta power facilities. While coal is an international and "north-south" market, meaning Canada-US trade is larger than interprovincial, Luscar does play a significant role in providing eastern Canada with coal.

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CLEAN COAL: OXYMORON OR NEXT BIG THING?  
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11. Although Alberta may be in the middle of a quiet rediscovery of coal's benefits, many still view the energy source as a necessary evil, at best. In a nation already embarrassed by the prospect of being beaten by the United States in lowering greenhouse gas emissions, any support of coal technologies is sure to raise eyebrows. However, if the Canadian Clean Power Coalition (CCPC) has its way, much of coal's negative effect on climate change and air quality could be eliminated. The coalition, which receives substantial support from the province, Ottawa, and the coal industry, sponsors a research initiative aimed at building a commercially viable power facility fueled by coal and emitting zero greenhouse gases by 2012. With the first phase now completed, CCPC hopes to retrofit an existing coal-fired plant by 2007 to demonstrate new technologies developed in Alberta. Much of the research has been focused on coal gasification and the process of amine-scrubbing, through which carbon dioxide is separated from other waste gases produced by burning coal. A carbon sequestration project, located near Weyburn, Saskatchewan (reftel) is developing techniques for pumping carbon dioxide into the oilsands, hoping to replace natural gas as the primary method for bringing heavy crude oil to the surface. The fortuitous timing of the two projects may enable Alberta to free up valuable natural gas, increase crude oil yields, decrease carbon emissions, and increase the value of the province's extensive coal reserves over the next decade.

12. Many conservationists argue that if this sounds too good to be true, it's because it is. The cost of carbon sequestration is still prohibitively expensive, and the possibility for leakage remains a concern. The diversion of funds to both projects has angered renewable energy researchers, who say Canada should focus more on developing proven technologies like solar or wind power rather than rehabilitating one of the world's worst contributors to global warming.

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COMMENT  
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13. While the United States imports minimal amounts of Alberta's coal, the indirect impact of growth in the industry will be substantial. The development of clean coal technologies, as President Bush has recognized with the Clean Coal Power Initiative, will likely play a significant role in solving some of the worst environmental hazards facing the world, including climate change. The December 7th announcement from American clean coal proponent FutureGen concerning plans for the construction of a zero-emissions coal plant by 2012 emphasizes the importance of developing these technologies. The efforts of the CCPC and the Weyburn Project in Canada have proven the technical feasibility of clean coal; FutureGen is proving its economic. If the province's research into clean coal and development of its abundant resource wealth is successful, the resulting increase in natural gas and oil supplies, and decrease in emissions, will contribute to a more unified, cleaner, and less energy-dependent North America.

14. This cable was drafted by our fall intern, David Dill.  
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